

GTE Price Caps

Basic Principles of Price Caps

- ◆ Price Caps review should look to the future
- ◆ Make as symmetric as possible with other competitors (AT&T, CAPS, cable industry, etc.)
- ◆ Let market guide efficient investment in the NII
- ◆ Price Caps should provide competitive pricing signals and reasonable expectations for all participants

GTE Price Caps

Basic Principles of Price Caps (Continued)

- ◆ Price Caps must accommodate existing competition and anticipate future competition
 - GTE is already facing substantial access competition
 - GTE has responded to competition by price reductions, service quality programs, etc..
- ◆ Price Cap structure should provide flexibility to meet market conditions
 - Current rules inhibit new services, customer satisfaction and innovation

GTE Price Caps

Basic Principles of Price Caps (Continued)

- ◆ Price Caps must be fair
 - Flexibility should permit adaptation to specific market situations
 - Productivity factors must be clearly derived and consistently applied
 - Some market participants (LECs) should not be manipulated for the advantage of others (IXCs)
- ◆ Price Cap decisions should move in the direction of access reform
 - Make the maximum progress possible now
 - Continue the process of reform needed in an increasingly competitive access market

GTE Price Caps

Perspective on Price Caps
GTE's Interstate Rate of Return
During the Price Cap Period

1991	11.74%
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1992	11.22%
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1993	10.25%
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GTE Price Caps

Perspective on Price Caps (Continued) GTE's Earnings Compared to Similar Firms (1991 - 1993)

		S&P Industrials Percentile
AT&T's actual earned ROE	16.45%	69.15%
MCI's actual earned ROE	18.90%	75.80%
GTE's implied interstate ROE	12.85%	54.26%

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Perspective on Price Caps (Continued) GTE's Infrastructure Investments (\$ in millions)

1989	\$2,843
1990	2,870
1991	2,737
1992	2,663
1993	2,666
1994 (Estimated)	<u>2,663</u>
Total	\$16,442

GTE Price Caps

Need for Access Reform

- ◆ Need to accommodate differing degrees of competition
 - By service
 - By location
- ◆ Markets can be classified as
 - Initial Market Area (IMA)
 - No competition
 - Transitional Market Area (TMA)
 - Existence of competition
 - Competitive Market Area (CMA)
 - Very active competition

GTE Price Caps

Competition Experienced by GTE GTE's Below Cap Pricing (\$ in 000)

Carrier Common Line	\$351,280
Total Traffic Sensitive	36,909
Total Trunking	26,688
Interexchange	<u>6,285</u>
Total Access	\$421,162

GTE cut access prices by approximately \$0.7 billion from the beginning of Price Caps through May 1994. Conversely, interstate long distance rates have increased 13%.

GTE Price Caps

GTE's Competitive Threat from CAPs

- ◆ GTE has CAPs operating in its major market areas, such as Los Angeles, Durham, Tampa, and Dallas.
- ◆ GTE also has CAPs operating in many smaller communities such as Fort Wayne, IN, Grand Rapids, MI, Beaverton, OR, Hobbs, NM, and Broken Arrow, OK.
- ◆ GTE has at least one CAP in each of its 10 largest wire centers (ranked by usage).

GTE Price Caps

Competition from Cable Affiliated CAPs and LECs

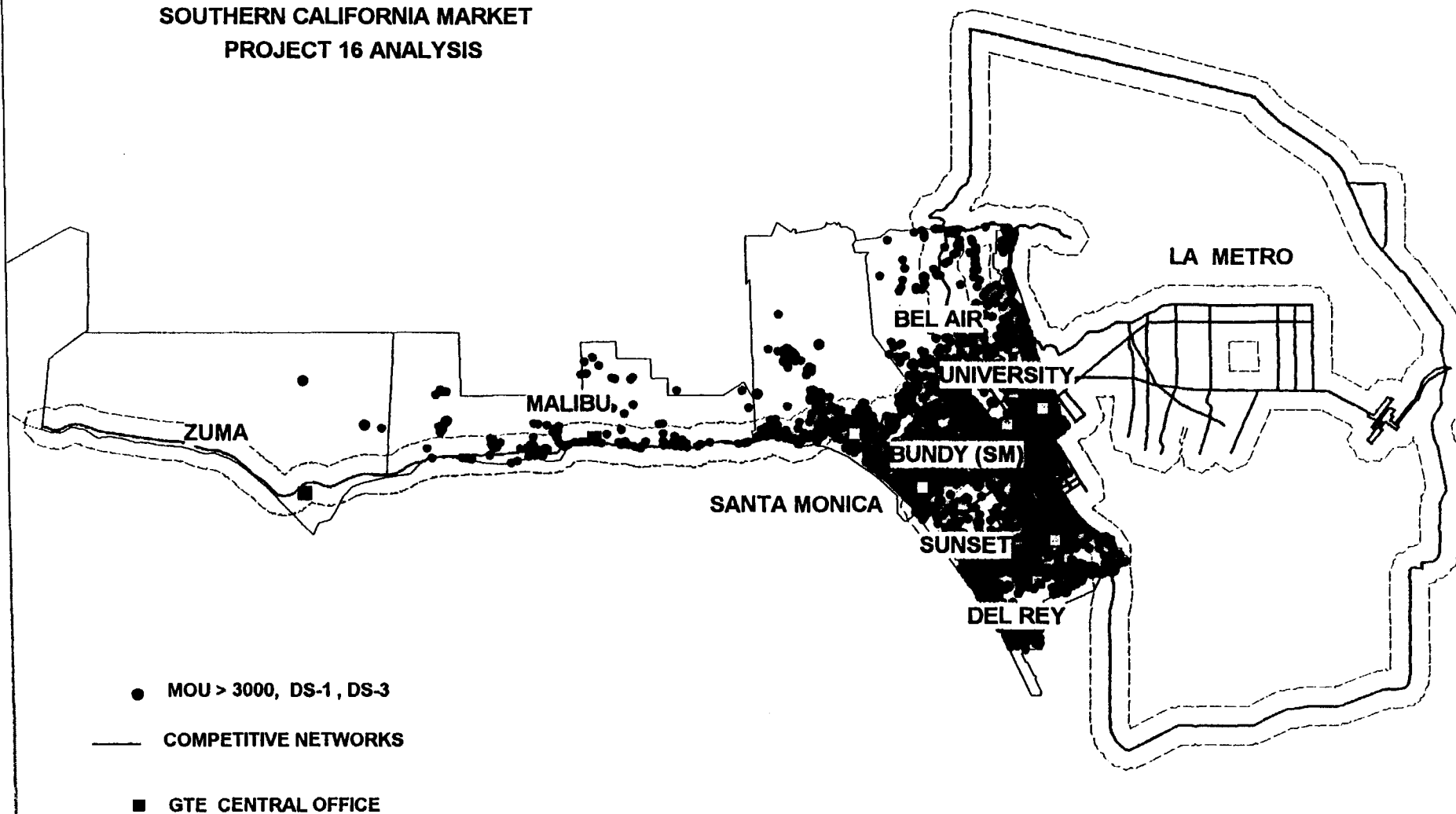
- ◆ TCI/Teleport in Dallas, Seattle, and Los Angeles areas
- ◆ Jones Lightwave in St. Petersburg, FL.
- ◆ Indiana Digital Access in Indianapolis and Lafayette
- ◆ Time-Warner Communications throughout Ohio

GTE Price Caps

Electric Utilities in GTE's Operating Areas Are Actively Seeking to Become Competitors

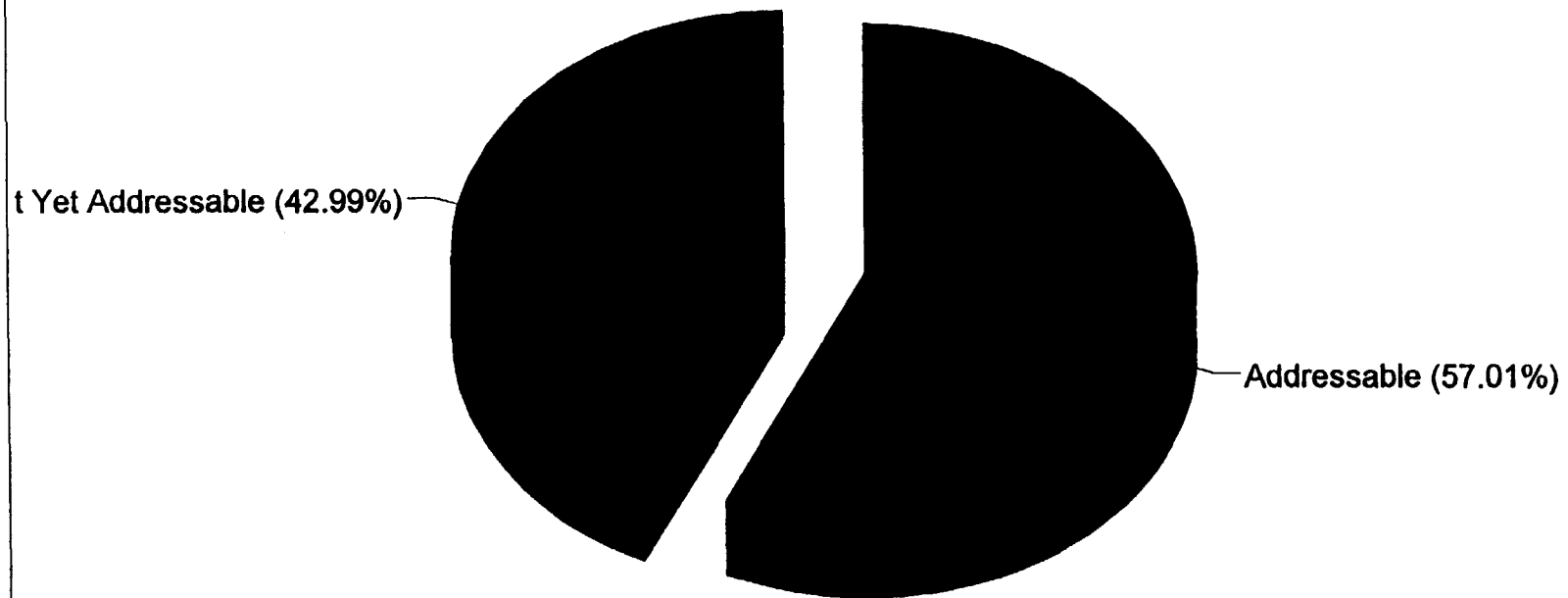
- ◆ Tampa Electric Company proposed to the NTIA that the electric network is the natural choice for establishing tomorrow's communications links.
- ◆ TECO presently negotiating joint venture with MFS and Intermedia Communications Inc. of Florida

**SOUTHERN CALIFORNIA MARKET
PROJECT 16 ANALYSIS**



Addressability Analysis

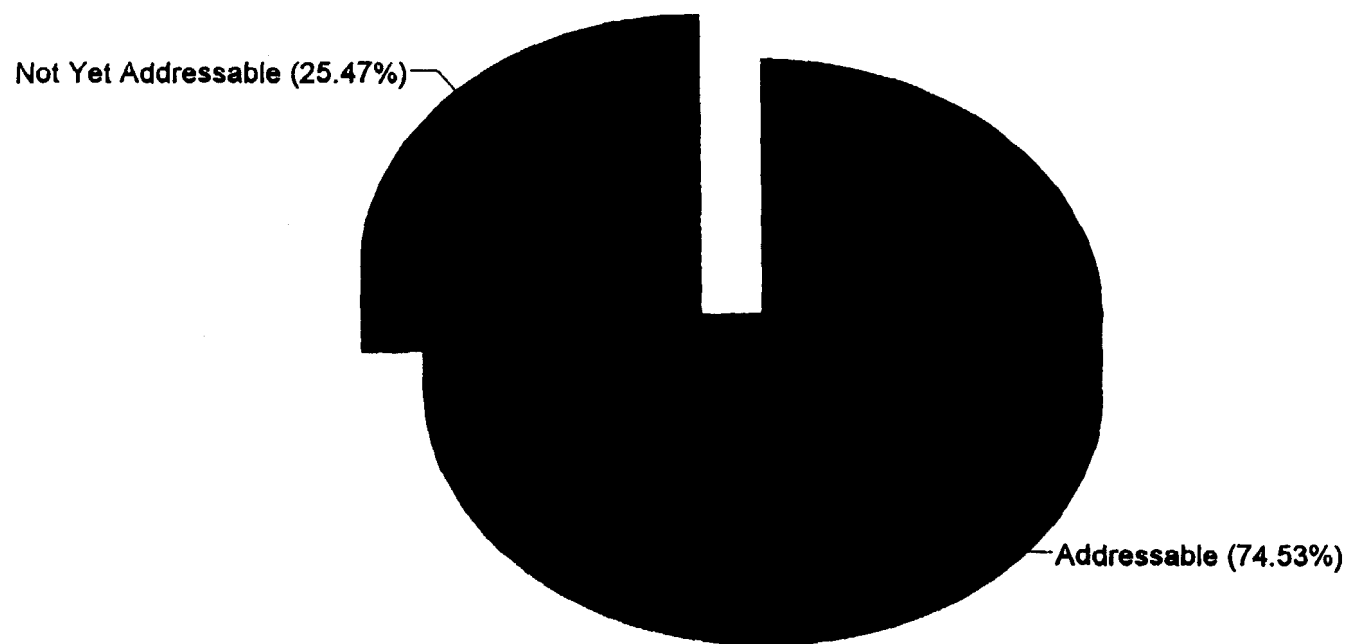
End User Switched & Hi-Caps



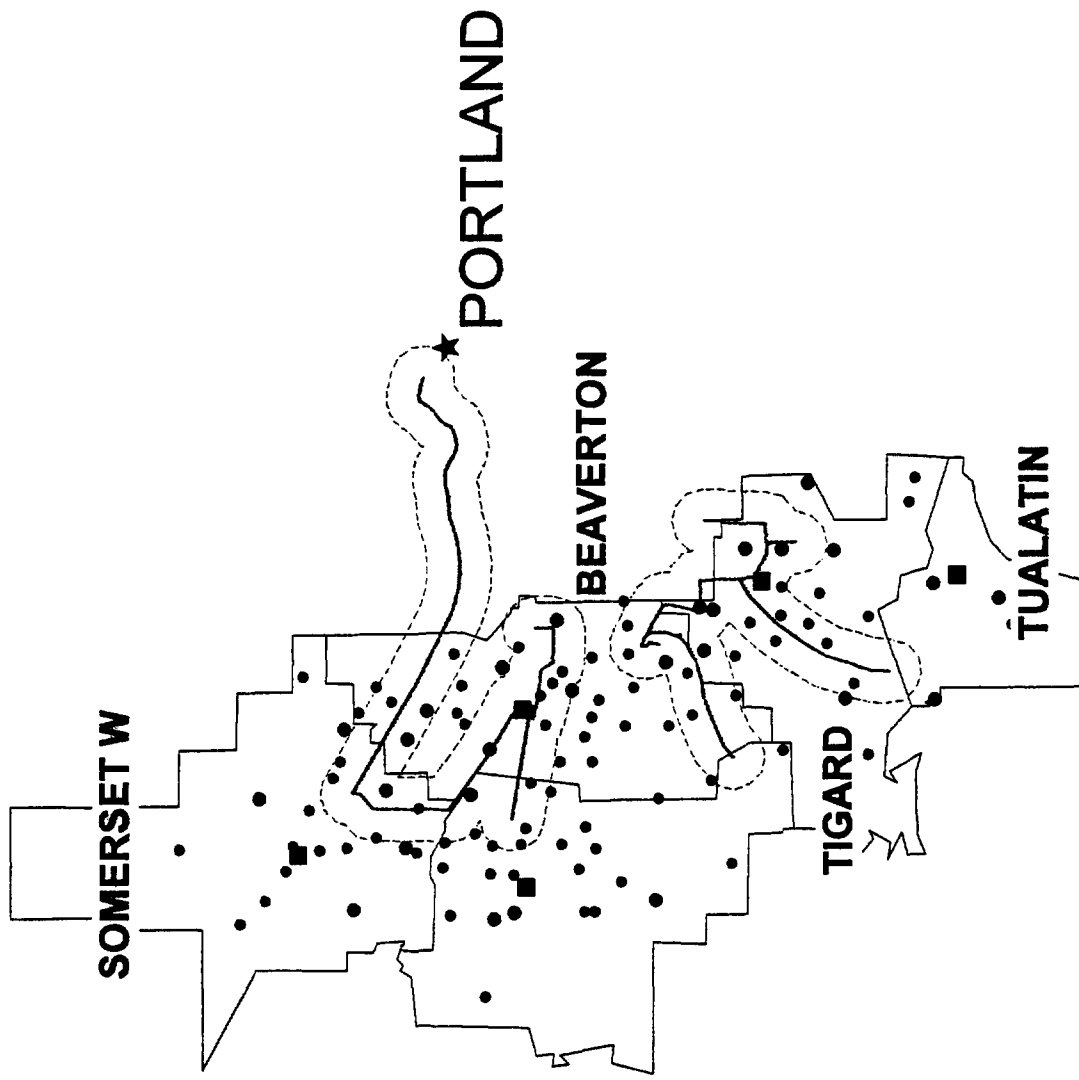
Addressability Analysis

End User Switched & Hi-Caps

SANTIA MONICA / BUNDY



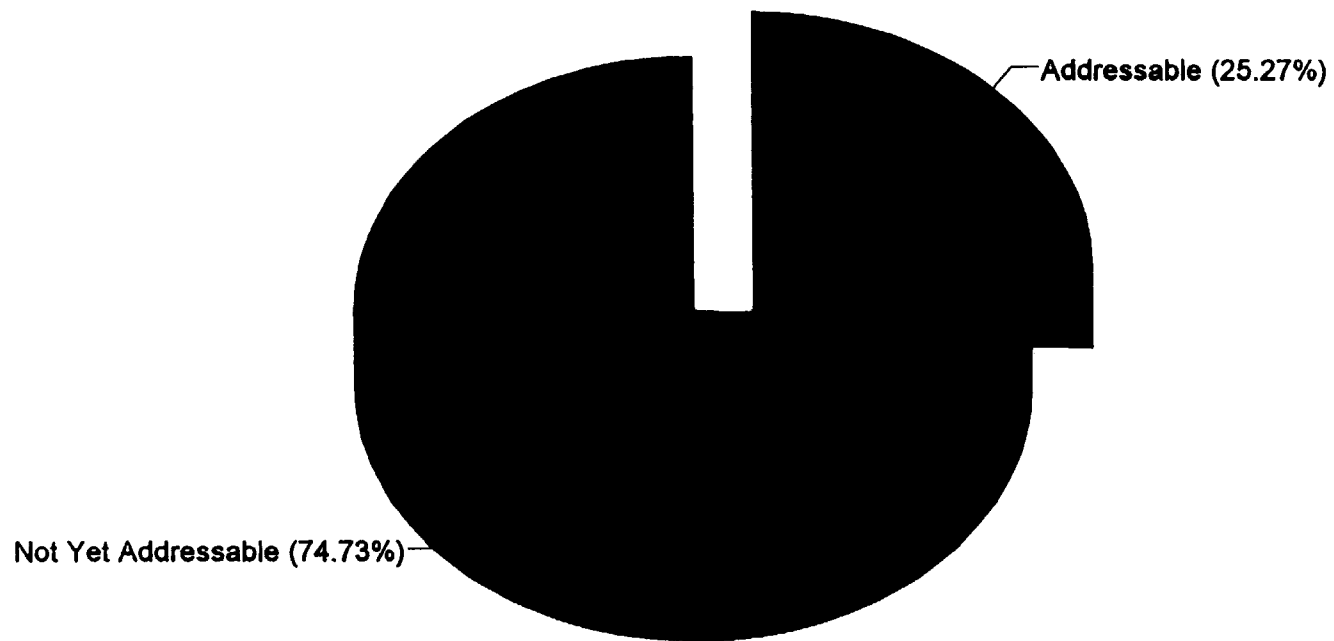
BEAVERTON



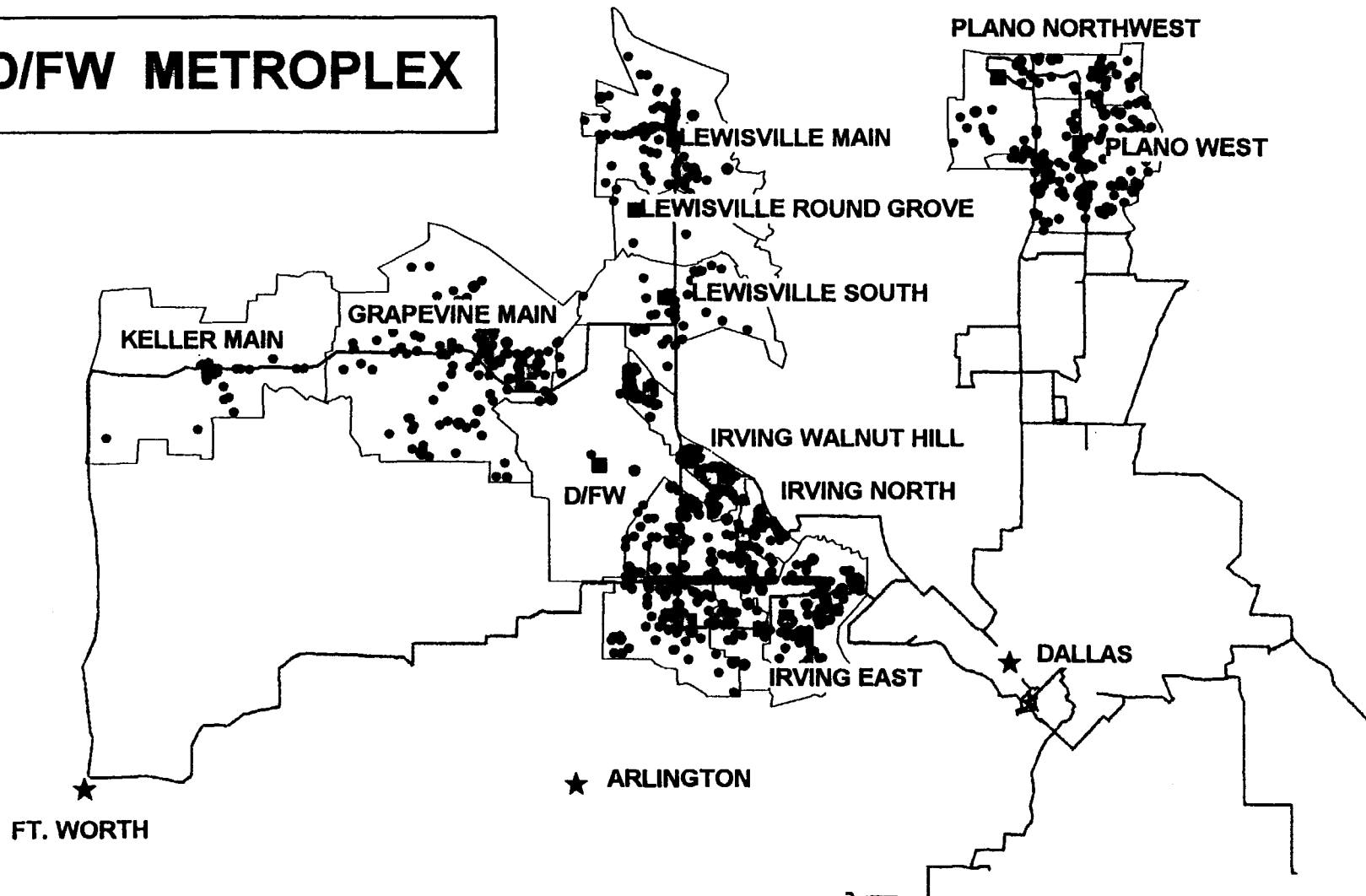
Addressability Analysis

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BEAVERION



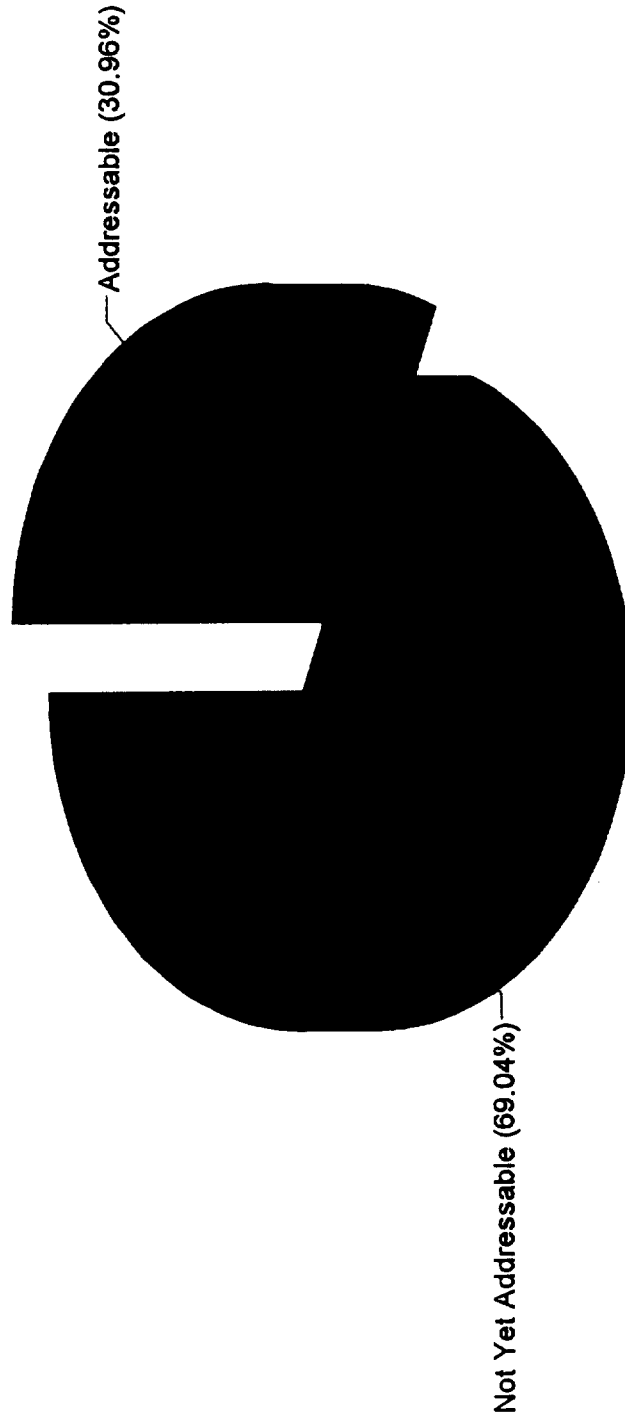
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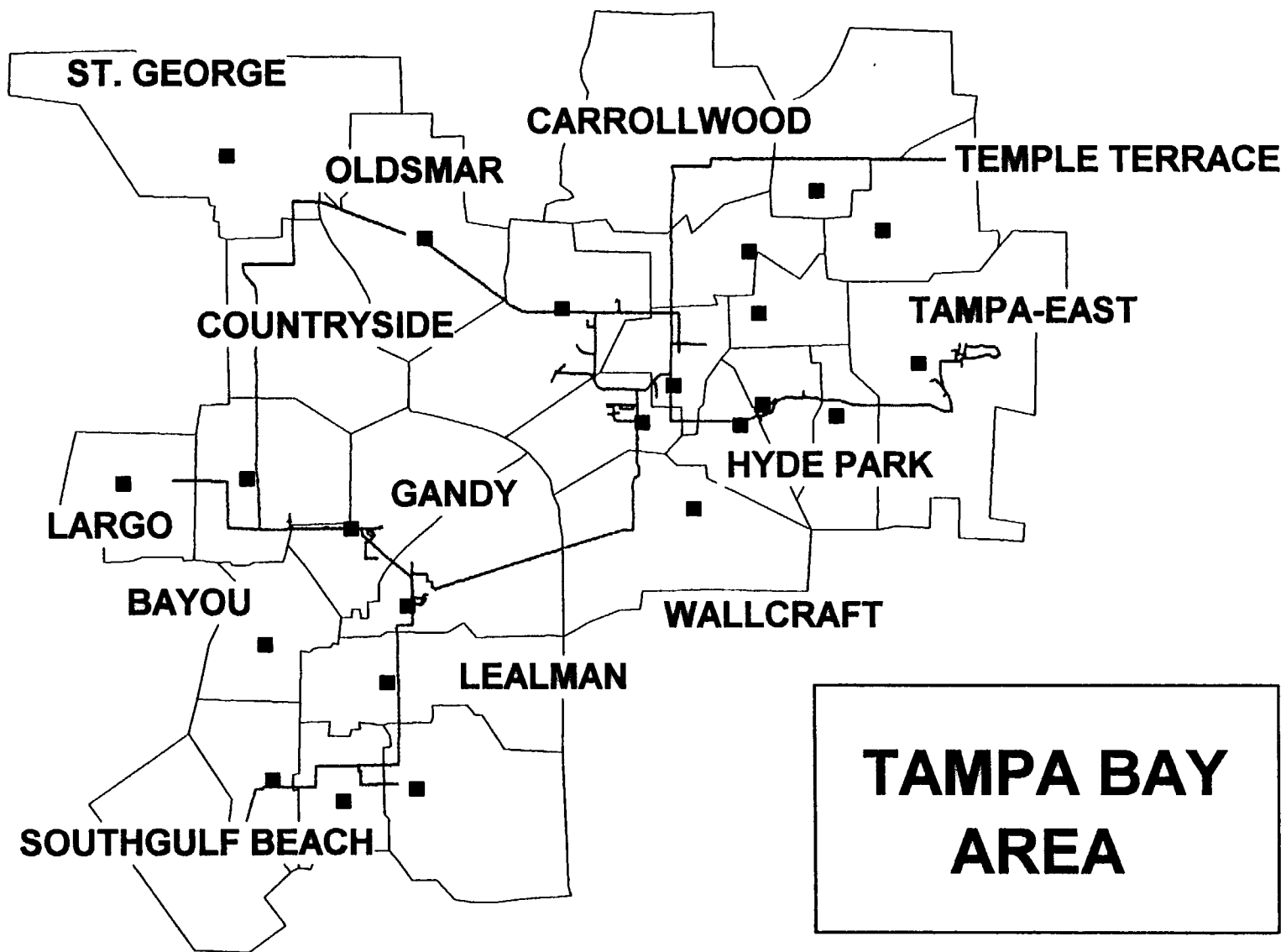


Addressability Analysis

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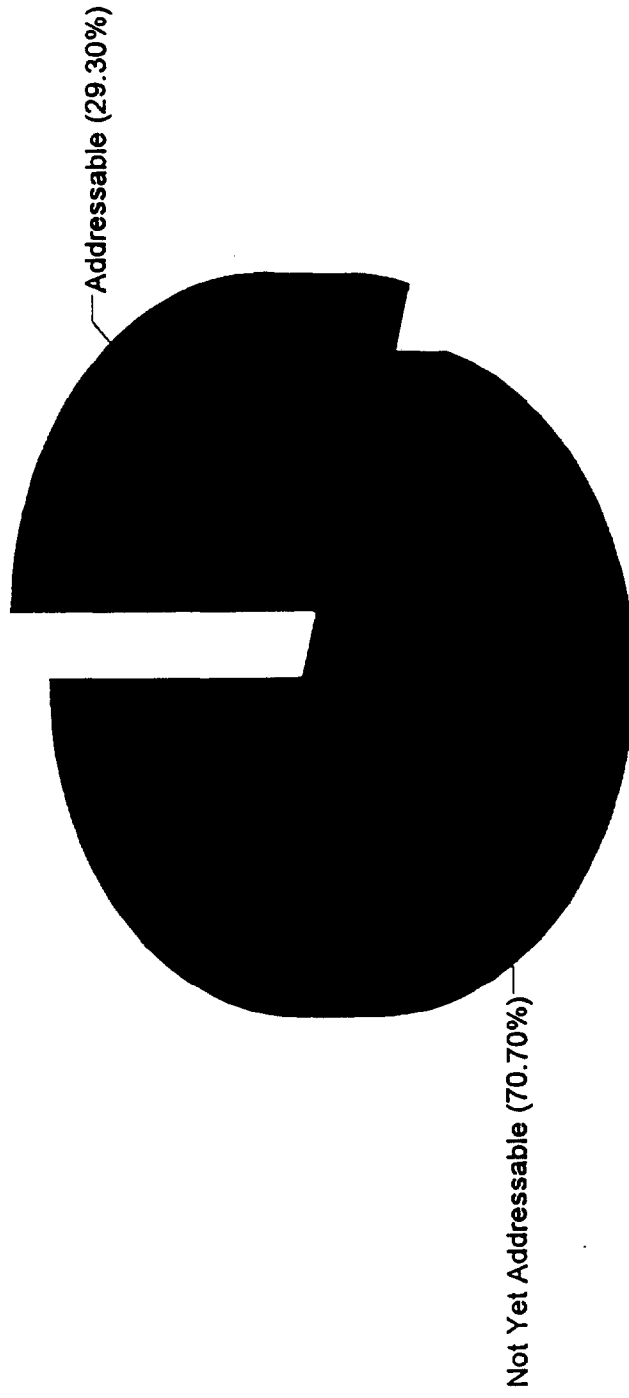
IRVING/PLANO





Addressability Analysis

End User Switched & Hi-Caps



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January 18, 1995

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JAN 18 1995

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W. - Room 222
Washington, D.C. 20554

RE: Ex Parte Notice
CC Docket No. 94-1

DOCKET FILE COPY ORIGINAL

Dear Mr. Caton:

Attached is a USTA filing in the above-referenced docket. The original and a copy of this ex parte notice are being filed in the Office of the Secretary. Please include it in the public record of this proceeding.

Respectfully submitted,

A handwritten signature in cursive script, reading "Mary McDermott", is positioned above the typed name.

Mary McDermott
Vice President & General Counsel

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JAN 18 1995

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY**

In the Matter of)
)
Price Cap Performance Review) CC Docket No. 94-1
for Local Exchange Carriers)

A USTA PROPOSAL FOR THE LEC PRICE CAP PLAN

Through the LEC price cap review, the FCC can make access customers better off than they are under today's plan, increase the momentum toward a truly competitive market where pervasive regulation is unnecessary, and give LECs a chance (but not a guarantee) of success in this changing market. A properly structured plan can provide additional incentives for the carriers regulated under it to make infrastructure investments.

If the FCC fails to adopt a plan that thoughtfully balances all of these goals, the loser will not only be the local exchange industry. It will be the American public. With this fact in mind, USTA hereby modifies its position in this docket and offers the following comprehensive proposal to achieve the critical balance.

I. USTA'S PROPOSAL FOR A NEW PRICE CAP OPTION BEST ADVANCES THE FCC'S GOALS.

The FCC should permit local exchange carriers to elect a new price cap option in which a moving average automatically adjusts the productivity offset,

replacing both sharing and the lower formula adjustment. This new price cap option severs the ties to rate-of-return regulation. USTA has consistently demonstrated that the FCC must take this step. With this new proposal, we add features that make it easy for the Commission to do so.

A. The Moving Average Productivity Offset

In lieu of sharing and the lower formula adjustment, USTA proposes automatically updating the productivity offset via a moving average. This moving average automatically ensures that customers share in any productivity gains realized by the LEC industry. We believe it is appropriate to use a five-year average of LEC Total Factor Productivity with a two-year "lag". Attachment 1 is an in-depth discussion of how the moving average would work as well as the benefits of adopting it. Using a TFP methodology, the offset can be routinely calculated by the FCC itself or by another independent party.

The moving average resolves the problems associated with a fixed productivity offset that does not change to reflect the industry's on-going productivity performance. And because the moving average will rise if, in fact, achieved productivity increases, there is no need for a permanent Consumer Productivity Dividend (see Section B). Indeed, a permanent CPD would result in double-counting of productivity improvements.

B. The Consumer Productivity Dividend and Its "Phase Down"

In the original LEC price cap plan, the Commission included a .5% Consumer Productivity Dividend (CPD) to guarantee that customers shared in the plan's benefits. The CPD did so by delivering anticipated improvements in productivity "up front" to customers. In the new price cap option, USTA proposes including an initial CPD of 1% that would "phase down" as the rolling average mechanism becomes established. (For example, reflecting more of the years when the LECs were under some form of incentive regulation in the federal – and most state – jurisdictions.)

Because new data is automatically incorporated into the moving average, there will be no need to attempt to predict future productivity gains. However, because the moving average contains a 2-year lag, the CPD would continue in Year 2, but at the "phased down" level of .5%. Similarly, in Year 3 of the new option, a .25% CPD would be retained. Beyond the third year, the CPD would be eliminated as the moving average takes over in ensuring that any productivity gains are passed on to customers.

C. One-Time Reduction in the Price Cap Index

In order to immediately share the benefits of the new option with customers, LECs choosing it would make a 1% reduction in their Price Cap Indices (PCIs). It is true that the moving average ensures that the benefits of the

plan's productivity incentives are eventually passed on to customers. But USTA believes that an improved price cap plan will benefit customers as well as LECs and so designed the new option to provide some of the expected benefits "up front". With this PCI reduction, as with the CPD, the LECs ensure these customer benefits and assume the risk of actually achieving productivity improvements in the future.

D. Narrowing Exogenous Cost Categories

Another aspect of the current plan that has been controversial is "exogenous costs". As part of formulating our integrated plan, USTA has examined this aspect of the plan and proposes to narrow the categories of costs that qualify for exogenous treatment. We have tried to identify those changes which uniquely affect telecommunications companies and that are the least controversial of the current exogenous categories. This narrower definition of exogenous costs would include only government mandated changes that uniquely affect telecommunications companies and changes in long term support mechanisms (i.e., universal service funding).